

CREDIT OPINION

8 May 2017

New Issue

Rate this Research >>

Contacts

Denise Rappmund 214-979-6865
 VP-Senior Analyst
 denise.rappmund@moody's.com

Edward (Ted) 212-553-6990
 Damutz
 VP-Sr Credit Officer
 edward.damutz@moody's.com

City of Arlington, TX Municipal Drainage Utility System

New Issue - Moody's Upgrades to Aa1 Arlington, TX's Municipal Drainage Utility Revenue Bonds

Summary Rating Rationale

Moody's Investors Service has upgraded to Aa1 from Aa2 the rating on the City of Arlington Municipal Drainage Utility System's (TX) outstanding revenue bonds, and assigned a Aa1 to the \$8.2 million Municipal Drainage Utility System Revenue Bonds, Series 2017. Post-sale, the drainage utility will have \$27.4 million of debt outstanding. The outlook is stable.

The upgrade to Aa1 reflects the system's large and diverse service area though small and more limited operations characteristic of a storm water system. The rating further considers the notably above-average system liquidity position and debt service coverage levels, and modest debt profile supported by adequate legal provisions protecting bondholders.

Credit Strengths

- » Gross revenue pledge
- » Strong and stable debt service coverage ratios
- » Above-average system liquidity

Credit Challenges

- » Springing debt service reserve fund
- » Additional capital needs with debt issuance expected over the near term

Rating Outlook

The stable outlook reflects the expectation that despite additional debt plans for the utility system, already-adopted rate increases through 2020 will continue to provide above-average debt service coverage ratios.

Factors that Could Lead to an Upgrade

- » Reduction in the ratio of debt to operating revenues
- » Strengthening of the legal structure

Factors that Could Lead to a Downgrade

- » Material decrease in unrestricted reserves

» Trend of declining debt service coverage below historic levels

Key Indicators

Exhibit 1

ARLINGTON DRAINAGE UTILITY SYSTEM					
System Characteristics					
Asset Condition (Net Fixed Assets/ Annual Depreciation)	46 years				
System Size - O&M (in \$000s)	3,430				
Service Area Wealth: MFI % of USmedian	95.00%				
Legal Provisions					
Rate Covenant (x)	1.10x				
Debt Service Reserve Requirement	DSRF funded a less than 3 prong test or springing DSRF				
Financial Strength					
	2012	2013	2014	2015	2016
Operating Revenue (\$000)	10,536	10,815	10,774	12,160	13,575
System Size - O&M (in \$000s)	2,874	2,845	2,909	3,110	3,430
Net Funded Debt (\$000)	25,365	23,981	21,867	20,502	18,482
Annual Debt Service Coverage (x)	3.03x	3.44x	3.39x	4.17x	4.57x
Cash on Hand	3288 days	3040 days	2186 days	1923 days	1940 days
Debt to Operating Revenues (x)	2.4x	2.2x	2.0x	1.7x	1.4x

Annual debt service coverage is presented as net revenues relative to debt service; the legal pledge is a first lien on gross operating revenues.

Source: Moody's Investors Service; bond ordinance and city audited financial reports

Detailed Rating Considerations

Service Area and System Characteristics: Large and Diverse Service Area in Dallas/Fort Worth Metroplex

Arlington's Municipal Drainage Utility benefits from a stable customer base. Located in Tarrant County (Aaa stable), the city of Arlington (Aa1 stable) has a large and diverse tax base characterized by residential development (nearly two thirds of the base) as well as significant industrial and commercial development, including ATT Stadium, the Dallas Cowboys and Texas Rangers sports franchises, UT Arlington, and major amusement parks, General Motors (manufacturing and finance), and healthcare establishments. The city serves as a regional employment center located equidistant from Fort Worth (Aa2 stable) and Dallas (A1 negative). New development and redevelopment in the city has bolstered growth over the past five years, bringing the city's fiscal 2017 tax base to \$20.4 billion, with an expectation of continued growth for fiscal 2018. The city is mature although experiencing modest growth in population, which currently stands at approximately 383,000.

The utility collects revenues demonstrates strong collections from a diverse base of accounts. Residential and commercial rates are billed monthly through the city's utility billing system. Collection of fees is strong because failure to pay may result in discontinuance of any utility services provided by the city. Residential properties are charged a flat monthly fee while commercial properties are charged based on the amount of impervious area square footage. Residential drainage utility customers account for 96% of the customer base by count of units served, though billing is split more evenly between residential and commercial customers. The system's historical number of accounts has been relatively stable over the past five years, and at present is equal to 100,939 units. The top ten drainage utility customers accounted for a small 4% of 2016 revenues.

Debt Service Coverage and Liquidity: Very Strong Debt Service Coverage Will Slightly Moderate But Remain Healthy With New Debt Issuance

Debt service coverage and system liquidity are above average and will remain strong despite additional debt issuance plans. In 2014 the city adopted a new fee structure which includes increasing the current flat fee of \$5.75 per month to \$7.50 per month through

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

2020 in anticipation of future capital needs. In fiscal 2016, debt service coverage based on the legal security of gross revenues produced very strong coverage of 6.1 times debt service. Despite gross revenue pledge, Moody's also assesses debt service coverage based on net revenues given the operating costs of the system are expected to continue. Fiscal 2016 net revenues produced coverage that was still very healthy at 4.6 times debt service. When factoring in additional debt issuances planned for fiscal years 2018 and 2019, as well as the adopted rate increases through 2020, debt service coverage based on net revenues is expected to stay above 3.0 times debt service.

LIQUIDITY

Drainage system fiscal 2016 unrestricted liquidity is very strong \$18.2 million, or 1,940 days of expenses. The nominal amount of unrestricted cash has stabilized over the past three years in the range of \$16.2-\$18.2 million, though expenses continue to grow, reflecting the declining trend of days cash on hand. Unrestricted reserves are expected to remain above-average over the near term.

Debt and Legal Covenants: Low Debt Profile and Adequate Legal Structure

DEBT STRUCTURE

The drainage utility's debt level relative to 2016 operating revenues is low at 1.3 times. Despite planned issuance for capital improvements in 2018 and 2019, with growth in revenues from adopted rate increases, the ratio of debt to revenues will remain low over the near term. Debt amortization is favorable with 60% of principal amortized within ten years.

DEBT-RELATED DERIVATIVES

The utility system is not a party to any derivative agreements.

LEGAL COVENANTS

The bonds are secured by first lien on gross revenues of the system; therefore, debt service payments are the highest priority in the flow of funds. Under the bond indenture, the city covenants to set rates sufficient to yield net revenues that provide 1.10 times MADS coverage. To issue additional parity debt, gross revenues must provide 1.25 times MADS coverage of current and proposed debt. The bond ordinance further requires the maintenance of a debt service reserve fund equal to maximum annual debt service should debt service coverage fall below 2.0 times. The reserve fund may be funded over a period of 60 months.

Management and Governance: System Managed by Strategic and Forward-Looking Team

Management of the city of Arlington municipal drainage department provide departmental administration within the framework of the city's council-manager form of government. Management of the system has been characterized by prudent fiscal practices and forward-looking capital planning.

Legal Security

The bonds are secured by a first lien on the gross revenues of the system.

Use of Proceeds

Proceeds of the 2017 bonds will be used for channel repair, erosion pilot programs and other improvements to the system.

Obligor Profile

The city of Arlington, TX is located in the center of the Dallas/Fort Worth Metroplex. The city encompasses 99.5 square miles and has a current population of approximately 383,000. The city operates its municipal drainage system as a self-supporting enterprise fund. The drainage utility was established in August of 1990 to protect the public health and safety from loss of life and property caused by surface water overflows and surface water stagnation.

Methodology

The principal methodology used in this rating was US Municipal Utility Revenue Debt published in December 2014. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Ratings

Exhibit 2

Arlington (City of) TX Muni.Drainage Util.

Issue	Rating
Municipal Drainage Utility System Revenue Bonds, Series 2017	Aa1
Rating Type	Underlying LT
Sale Amount	\$8,230,000
Expected Sale Date	06/15/2017
Rating Description	Revenue: Government Enterprise

Source: Moody's Investors Service

© 2017 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1068968

Contacts

Denise Rappmund
VP-Senior Analyst
denise.rappmund@moody.com

214-979-6865

Edward (Ted) Damutz
VP-Sr Credit Officer
edward.damutz@moody.com

212-553-6990

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454